TRUST COMPANIES AND RESERVES

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The difference between a civilized and a barbarous country, from a commercial point of view, is that one uses credit largely, and the other but little. Credit rests upon cash; banking rests upon cash. A reserve is the foundation on which the superstructure of credit rests, and it must be broad enough to carry the weight. A reserve is little used in ordinary times, but it is kept not only for a basis of credit, but for actual use in times like the present. In 1893, as well as this year, the clearing-house banks in New York decreased their reserves from 25 per cent to 20 per cent, and by so doing kept the Stock Exchange open, relieved the trust company situation, shipped money to the interior, and in general built a bulwark against extreme fright and loss. Another important thing about reserve is mobility. The clearing-house banks, by acting together without friction or trouble, and by the issuance of clearing-house certificates, automatically helped their weaker members, and the weaker banks obtained such help as was necessary without delay or humiliation. Even before the loan certificates were issued, it was easy for the clearing-house banks, with their accumulated reserves, to pay if necessary the deposits of the three banks which needed assistance and reorganization. Compare this with the halting, irregular, and protracted manner in which the two trust companies were helped! There were lines of anxious depositors outside their doors for weeks. These trust companies could not immediately obtain the requisite assistance. This shows the difference between the disadvantages of the slight trust company reserves, as now managed, and the tried and ample reserves of the clearing-house banks. The claim that additional cash reserve takes money out of circulation is without force if reserves are insufficient.

Deposits of the clearing-house banks in the City of New York

have increased from $370,300,000 in 1893 to over one billion dollars, owing in part to the large increase in the production of gold in the world. The clearing-house banks have built up their cash reserves since 1893 from $93,000,000 to $256,000,000. The fact that the trust companies in the Borough of Manhattan have not increased their reserves correspondingly while their deposits have been increasing, from about $224,000,000 in 1893 to over one billion dollars in 1905 has contributed to the present panic. A billion dollars in deposits is a superstructure that cannot be maintained on a 5 per cent cash reserve, and it was sure to topple over.

Time Favorable for Increasing Reserves

There is a difference between the periodical lock-up of funds in the United States Treasury and the gradual increase of reserve by banks and trust companies, because after the reserve has once been accumulated it fluctuates only as the deposits rise and fall. We are in a position similar to that of a country desiring to get on a gold basis. Gold naturally flows where it is most desired. Just at this time the accumulation of additional reserve can be easily accomplished. In the panic of 1893, after the reserves of the clearing-house banks had gone down to 20 per cent, as was the case this year, they increased before the end of the year to about eighty million dollars surplus reserve above 25 per cent. This was on $506,000,000 deposits—less than half of our present deposits in clearing-house banks. The same increase after the close of our present stringency would give the banks over $160,000,000 surplus reserve; should we succeed in getting this amount it would be nearly enough for the reserves of the trust companies. Another reason why this is an exceptionally good time for building up reserves is that the trust company deposits are low, and a relatively smaller amount of cash will be required. A similar situation cannot be expected to occur until after the next panic.

If the trust companies, with or without legislation, will judiciously lock up the coming plethora of money in their own vaults, they will hold, in whole or in part, the gold which has been shipped here in such large quantities, and the rates of discount will not be high.

Trust Companies Should Keep Their Own Reserves

There is a reason for country banks keeping reserve accounts in New York, because their business requires them to draw on New York, but there is no economic reason for a trust company to keep a reserve account in another institution in the same city, other than in a central reserve bank like the Bank of England. A few years ago, even as late as 1897, when the trust company deposits were only $258,000,000, they were small compared with the deposits of the clearing-house banks, and it was not a matter of so much importance, but now when the trust company deposits have been nearly equal to those of the clearing-house banks, the situation is serious.

One objection to allowing the reserve of one institution to be kept in another institution in the same city has developed in the recent panic. Under the reciprocal reserve plan Trust Company A deposits $500,000 with Trust Company B, Trust Company B deposits an equal sum with Trust Company C, and Trust Company C deposits the same amount with Trust Company A, thus making one-half million dollars counted as reserve three times.

A number of the recent reports of the joint-stock banks in London show that even there they have leaned too much on the Bank of England, and that it is necessary for the joint-stock banks to keep a larger reserve in their own vaults.

Call Loans not a Substitute for Cash

It is objected that the cash reserves of trust companies are not necessary, as they do not depend upon the cash, but upon their call loans for fluctuations in deposits. This is no less true of the national and state banks in New York City, but the stock market, as well as all other business which is represented by dollars, depends upon cash. One of the things that the clearing-house banks have to do in a time like this is to see that sufficient money is lent to share and bond dealers, in order that there may be a market for the purchase and sale of securities. In 1873 clearing-house certificates were not issued early enough, and the condition of affairs became so chaotic that it was necessary to close the Stock Exchange for about ten days, and call loans could not be paid. Support comes from the reserves, and the trust companies should do their share.

Difference in Reserves Equivalent to a Rebate

If a town has a railroad rebate, the competitive town without the rebate goes to the wall. The press has shown how a system of rebates has destroyed competition. The present discrimination in favor of the trust companies, that is, between 25 per cent cash reserve and 5 per cent cash reserve, is 80 per cent. If the trust company cash reserves should be increased even to 20 per cent, the rebate against the banks would be 20 per cent—that is, the difference between 20 per cent and 25 per cent reserve. On the face of it the comparative profits of the trust companies and banks may not be of public interest, but a slight examination of the subject shows that good banking is essential to the public good. The competition of the trust companies, both in the city and state, has honeycombed the banking situation; it has tempted the banks, in order to meet the competition, to take long loans for better rates and take undue risks. It seemed necessary for the banks to do this in order that they might pay the same rate of interest as the trust companies did easily with their smaller reserve. The reports of the trust companies, state and national banks in the Borough of Manhattan, show that the trust companies get profit on 92.2 per cent of their resources, as against 70.3 per cent and 70.9 per cent by the national and state banks respectively; these figures show how great the rebate has been against the national and state banks in favor of the trust company business. Even should the reserves of the trust companies be increased to 20 per cent, they could frequently pay 1 per cent more interest than the banks carrying 25 per cent reserve. A few only of the old and established banks have, for themselves, met the situation by refusing to pay interest at all, but this is impracticable for the new or ordinary bank.

The Interest of a Few vs. Public Interest

The banking situation in New York is peculiar. There are banks which have heavy deposits from country banks, and to this extent they are protected from trust company competition. Other banks in Wall Street have large trust company deposits; this enables them to accept the trust company competition with profit. But the majority of the banks in the clearing house, as well as the thirty other banks in the Borough of Manhattan which are not in the clearing house, are not thus situated, and but few state and

national banks throughout the State of New York have any of the favorable conditions named above. They protest strongly against the bad banking which is induced by this unfair competition. Two state institutions doing substantially the same business should be under the same regulations as regards reserve, whether called banks or trust companies. The report of the New York State Commission appointed by Governor Hughes, properly tries to help the situation as far as the country is concerned, but the Borough of Manhattan is left to struggle with the difficulties alone, in a modified form.

There are 404 national banks in the State of New York, and 196 state banks, making 600 in all. Many of these banks have long and honorable records. The solution has been proposed by different trust company officers that the national and state banks should become trust companies. It can fairly be asserted that this would not be for the public good.

No Exclusive Right in Time Deposits

There is something amusing about the sacrosanct view regarding trust company deposits. There seems to be an implication that time deposits belong to the trust companies of right. Banks have always favored deposits likely to remain, and in fact, they are the cream of the business.

The majority of the above-mentioned commission tried hard to find some way of differentiating the trust company deposits, so as to arrange for one reserve on deposits subject to check and a different reserve on time deposits, but they found practical difficulties in enforcing any such provision.

Then the commission tried to arrive at what should be the reserve for total deposits. The statistics gathered by the committee, contained in the report, show that

The average gross deposits of the trust companies for three periods (January 1, 1906; January 1, 1907; August 22, 1907) were	$841,000,000
Deduct from this	
Average sums held as executor, etc.	35,000,000
Which leaves net deposits of	$806,000,000

The average deposits represented by certificates were $81,000,000, or only about 10 per cent of the net deposits. To represent

this 10 per cent of time deposits, the report allows the trust companies to keep 15 per cent cash reserve on their total deposits, as against 25 per cent cash reserve proposed for the banks in the Borough of Manhattan. This is really an allowance of 40 per cent in reserve to cover the 10 per cent of trust company deposits represented by certificates.

From my point of view this is not fair to the banks, as there are probably many banks which have more than 10 per cent of deposits which may fairly be called time deposits, such as funds awaiting investment, etc. The bank I serve is one, and such banks should be considered instead of discriminated against in new legislation. Why should not those deposits of banks which are really time deposits be considered as well as trust company time deposits? The banks have been driven into paying interest by the trust companies doing a banking business, and should have the same opportunities for receiving time deposits, on as favorable terms as the trust companies. In fact, banks were organized to receive deposits, while trust companies formerly only received deposits by inference. Trust companies already have advantages over banks in that they have a number of profitable functions other than receiving deposits.

Time Deposits Not Tested by Exchanges

The trust companies have argued that because the checks paid over their counters daily are not as large in volume as those which pass through the clearing house daily, it shows that their deposits are permanent, and therefore less reserve is necessary. This may or may not be true, because, taking a merchant for instance, while his average balance may remain practically the same, the transactions on his account may be very numerous.

Conclusion

A reserve for the state banks and trust companies in the Borough of Manhattan of 25 per cent in cash will put them on a par with the national banks, and will make the banking system uniform as regards reserve. Should this reserve prove too high, or too difficult of accomplishment, the reserve called for in the national bank act could probably be modified. At present the national banks are harassed by the unfair competition of the trust companies, as shown by the introduction of bills in Congress tending

to give them a better chance to compete with the trust companies. The express intention of the legislature to equalize the reserves of the national banks, state banks, and trust companies, would be a basis under which all would be working together under one reserve for sound banking, instead of working against each other, as is the condition at the present time, and the advantages of sound banking to the community as a whole can hardly be overestimated, in view of the anxiety, loss, and depression of business caused by the present panic.